

Internal Revenue Service

memorandum

CC:TL-N-9067-87

Brl:JCAIbro

date: AUG 24 1987

to: District Counsel, Honolulu CC:Hon
Attn: Carol K. Muranaka

from: Director, Tax Litigation Division CC:TL

subject: [REDACTED]

This is in response to your request for technical advice dated July 10, 1987 with respect to the notices of deficiency issued to the [REDACTED] as well as to other partners in the [REDACTED].

ISSUE

In light of the Tax Court opinion in [REDACTED], that [REDACTED] is subject to the partnership audit and litigation procedures, what action should be taken with respect to outstanding notices of deficiency mailed to other partners? RIRA Nos. 6221.00-00; 6225.00-00; 6226.00-00; 6229.00-00; 6233.00-00

CONCLUSION

Because the court determined that [REDACTED] is subject to the partnership audit and litigation procedures, all notices of deficiency with respect to the [REDACTED] taxable year are invalid. The assessment against the [REDACTED] must be abated and the other cases should be conceded or settled.

DISCUSSION

As we stated in the [REDACTED] technical advice, dated [REDACTED], the facts and circumstances regarding the ACTF partnership (the partnership in the [REDACTED] case)

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reveal that the partnership audit and litigation provisions apply to the [REDACTED] taxable year. Our analysis of the available facts as a whole, as well as the court's analysis, came to the conclusion that [REDACTED] was formed after [REDACTED]. We concur with your memorandum of July 10, 1987 that a successful appeal is unlikely given the court's factual determination that [REDACTED] was a partnership in [REDACTED] and actually commenced operations in [REDACTED].

In [REDACTED] as well as in L & B Land, slip op. at 6 the court noted that a partnership is formed when the parties to a venture join together with the intent of conducting presently an enterprise or business. See also Sparks v. Commissioner, 87 T.C. 1279, 1282 (1986). The factual determination of formation date flows from this general proposition.

In L & B Land, we believe that the court's formation date analysis depended on more than the terms of the subscription agreement and partnership agreement as you suggested in your memorandum. A review of all of the facts led to the conclusion that the partners intended that L & B be formed as of the date on which the last partnership unit was sold, but not later than October 31, 1982. The court even stated that "the record could hardly be clearer as to their intent." Slip op. at 8. The court's analysis necessarily responded to petitioner's contention that because the minimum subscription amount (40 units) had been sold by September 3, 1982, the subscriptions had become irrevocable by that date and thus L & B was formed on the date the subscriptions were no longer refundable. The court points out that it is not the irrevocability of subscriptions which is controlling for the purpose of determining formation date but rather the intent of the partners. In addition to the evidence provided by the terms of the subscription agreement and the partnership agreement, the court looked to the offering memorandum which stated the offering would close when all 99 units were purchased but not later than 10-31-82. The court also noted that a services agreement was executed on September 13, 1982, the same date the last unit was sold; no business was conducted by the partnership prior to September 13, 1982; and all contributed capital was deposited into an L & B account on September 10, 1982. In light of all these factors, the court concluded that as expressed in the partnership agreement, the parties intended to form L & B on September 13, 1982.

Other aspects of the L & B opinion which are important to note include the proposition that a determination of the existence of a partnership for Federal tax purposes is governed by Federal, not by state law. See Evans v. Commissioner, 447 F.2d 547, 550 (7th Cir. 1971) ("the legality, or lack of thereof, of a partnership under State law does not determine whether a partnership exists for federal tax purposes...."). Also, the

solicitation of capital from prospective partners does not create a partnership but rather the partnership is deemed formed as of the date on which the first parties to the venture acquire a proprietary interest in the capital or profits of the partnership. Slip op. at 7-8. This, of course occurred on the September 13, 1982 formation date as determined by the intent of the partners. See also Hensel Phelps Construction Co. v. Commissioner, 74 T.C. 939, 948-49 (1980), aff'd 703 F.2d 485 (10th Cir. 1983) (anticipated formation of a joint venture; no intent to join in present conduct of enterprise; no proprietary interest in capital or profits of alleged partnership).

With respect to the [REDACTED] opinion, we do not concur with your view that it is inconsistent with L & B Land. As you pointed out, of course, the private placement memorandum for [REDACTED] provided for a minimum subscription funding level of \$[REDACTED] and only when \$[REDACTED] in subscriptions was received would the partnership be formed and commence business. Whereas, the partnership agreement provided that the partnership commenced on the date the certificate of limited partnership was recorded. Not only did GP/TMP [REDACTED] never record the certificate of limited partnership, rendering meaningless this provisions in the agreement with respect to determining formation date of [REDACTED], but more importantly as the court explained in the opinion, there is a valid distinction between formation of a partnership for tax purposes and formation of a valid limited partnership under state law. Accordingly, the court looked to the facts and the intent of the partners on formation irrespective of the existence or non-existence of a partnership under the state law.

In its rendition of the facts, the court noted that during [REDACTED] and [REDACTED] subscription agreements were accepted for all [REDACTED] offered partnership units, and there were no refunds because more than the minimum [REDACTED] units were subscribed by the end of [REDACTED]. In considering the facts to determine formation date the court noted that by the end of [REDACTED] was fully subscribed, and all contributed capital had been deposited in [REDACTED] operating account. In addition, [REDACTED] entered into lease agreements in [REDACTED] and used partnership capital to prepay rent. Taken together, the court viewed all these actions as implementing the subscribers' intent to form a partnership in [REDACTED].

In [REDACTED], unlike L & B, the court was unable to establish an exact date as the formation date. Rather, based on the fact that [REDACTED] was fully subscribed by the end of [REDACTED] and the partners' capital interests had thus vested, the court also looked to [REDACTED] activities as general partner in entering into lease agreements. Absent a definite offering closing date or an exact formation date, the vesting of the capital interests along with the commencement of business by [REDACTED], conclusively demonstrated that by that date the partners had

joined together with the present intent of conducting a business enterprise. In effect, the commencement of business unequivocally implemented the intent to form a partnership. Given the dearth of facts the court was only able to state that [REDACTED] was a partnership "in [REDACTED]." Seemingly, the court's use of the leasing activity factor to support its conclusion on partnership formation was caused by an inability to identify an exact formation date from other facts and circumstances. It remains to be seen whether the court will continue to consider the commencement of operations in determining when a partnership is formed or whether it will be a factor only when other facts are scanty.

With respect to your view that the court focused on the date shown on the partnership return for commencement of business, and that in essence the court held that the dates shown on the return may estop the Service into applying the TEFRA procedures, we do not agree. Rather, the court correctly pointed out, that even if it had not been determined that [REDACTED] was a partnership in [REDACTED], section 6233 along with the filing of a partnership return for taxable year [REDACTED] would have brought the case within the purview of the partnership audit and litigation provisions.

The court stated, [REDACTED]:

In addition, [REDACTED] filed a partnership return, form 1065, for the taxable year [REDACTED] which stated that [REDACTED] had commenced business on [REDACTED], and issued forms K-1 to the partners. This fact alone suggests the applicability of the partnership audit and litigation provisions pursuant to section 6233(a).

Pursuant to section 6233(a), the sole "fact" that the court is referring to is the filing of the return. Although the court noted a stated business commencement date of [REDACTED] as shown on form 1065, there is no basis to conclude that the court relied on this date. Furthermore, the date is irrelevant with regard to section 6233(a). Nor did the court hold that the [REDACTED] date shown on the return estopped the Service into applying TEFRA. Rather, it is the filing of the return which brings the partnership under TEFRA pursuant to section 6233(a).

We continue to adhere to our view as expressed in the [REDACTED] technical advice at [REDACTED] that one factor that should not be relied upon in determining formation date is a representation in the partnership return as to formation date or date of commencement of business. Furthermore, the Tax Court also does not view such representations as reliable absent corroboration.

In Sparks, 87 T.C. 1279, the facts established that the form 1065 stated the partnership was actively operated for one month in 1982, and an amended return stated that the business was actively operated for 12 months in 1982 and was started on January 1-of 1982. The court placed no weight on the alleged January 1, 1982 commencement of business date in light of all the other facts which were considered. In [REDACTED], the partnership's [REDACTED] information return indicated it commenced business on [REDACTED] and operated for 12 months in [REDACTED]. The court noted that no other evidence in the record indicated that the partnership's taxable year commenced [REDACTED]; rather all other evidence consistently reflected a formation date subsequent to [REDACTED]. In L & B Land the court stated, Slip op. at 8, fn.7 that "the partnership information return states that L & B commenced business on September 8, 1982. That statement is unsupported."

The practical problem, of course, is the notices of deficiency issued to the other partners in the [REDACTED] tax shelter. Given the [REDACTED] factual findings, which we do not dispute, and the explicit statutory requirements in sections 6621-6233 for partnership proceedings, it is our opinion that there is no way to convert a petition filed with respect to a notice of deficiency to a section 6226 review of a final partnership administrative adjustment (FPAA) especially when an FPAA has not been issued.

We are cognizant of the incomplete information which was available to the Service at the time the notices of deficiency were issued. Perhaps the only way the Service could have protected the revenue at issue where the available facts were so inconclusive, would have been to issue notices of deficiency and notices of final partnership administrative adjustment, and the court could have determined which notice was within its jurisdiction.

We see no alternative to abateing the assessment against the [REDACTED] and conceding or settling with the other partners in this partnership.

ROBERT P. RUWE

By:



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